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Japan's Economy Fails To Reach 3 Percent Growth Mark In FY 1986

The effects of the strong yen held Japan's economy to 2.6 percent inflation-adjusted growth in FY 1986 (April 1, 1986-March 31, 1987), the lowest rate in 12 years. Economic performance fell short of the government's revised 3 percent projection despite an impressive 4.9 percent real gain (at an annual rate) in the last quarter (see Table). This recovery, though, suggests that the economy may have bottomed out.

Japan's Real Gross National Product at Constant (1980) Prices

(in billions of yen, seasonally adjusted, quarterly totals and rates of growth at annual rates)

	FY 1985	FY 1986	April- June 1986	July- September 1986	October- December 1986	January- March 1987
Gross National Product	Y293,332.7 (4.3%)	Y300,887.2 (2.6%)	Y297,230.1 (3.8%)	Y299,438.0 (3.0%)	Y301,619.4 (2.9%)	Y305,263.1 (4.9%)
Personal Consumption Spending	162,999.0 (2.6%)	167,867.7 (3.0%)	166,134.2 (5.0%)	168,282.5 (5.3%)	167,048.0 (-2.9%)	170,023.3 (7.3%)
Private Residential Construction	14,107.9 (2.9%)	15,956.5 (13.1%)	14,808.5 (13.7%)	15,851.9 (31.3%)	16,625.4 (21.0%)	16,728.8 (2.5%)
Private Fixed Nonresidential Investment	53,760.3 (12.9%)	56,336.5 (4.8%)	55,204.3 (1.6%)	55,471.9 (2.0%)	56,617.8 (8.5%)	57,920.4 (9.5%)
Change in Business Inventories	2,016.2 (8.7%)	812.3 (-59.7%)	639.5 (-98.1%)	920.4 (329.1%)	1,351.4 (364.8%)	340.7 (-99.6%)
Government Current Expenditures	27,240.9 (1.9%)	29,098.8 (6.8%)	27,719.2 (1.6%)	28,058.0 (5.0%)	32,065.4 (70.6%)	28,556.7 (-37.1%)
Government Fixed Investment	20,772.5 (-6.4%)	22,289.7 (7.3%)	21,785.4 (15.3%)	22,180.2 (7.4%)	22,428.9 (4.6%)	22,662.8 (4.2%)
Change in Government Inventories	297.9 (*)	825.5 (*)	3,251.8 (*)	1,795.1 (*)	-1,866.9 (*)	118.3 (*)
Net External Sector	12,138.1 (19.9%)	7,700.2 (-36.6%)	7,687.2 (-72.8%)	6,878.0 (-35.9%)	7,349.4 (30.4%)	8,912.1 (116.2%)
Exports of Goods and Services and Factor Income Received	54,496.6 (1.8%)	52,728.3 (-3.2%)	53,044.1 (6.6%)	52,640.0 (-3.0%)	52,127.4 (-3.8%)	53,149.0 (8.1%)
Imports of Goods and Services and Factor Income Paid	42,358.6 (-2.4%)	45,028.1 (6.3%)	45,356.9 (41.8%)	45,762.0 (3.6%)	44,778.0 (-8.3%)	44,236.9 (-4.8%)

*Cannot be calculated or meaningless.

Source: Economic Planning Agency

The Economic Planning Agency reported that domestic demand accounted for 4.1 percentage points of growth in fiscal 1986, but the final figure was pulled down 1.5 percentage points by the external sector. The appreciation of the yen, which made Japanese goods more expensive in terms of other currencies, produced the first decline in exports in eight years, depressing investment and employment by export-oriented firms. But domestic demand, led by the nonmanufacturing sector, achieved its highest growth rate since FY 1979. Boosted by low interest rates, housing starts surpassed the 1.3 million level for the first time in seven years, while a sharp increase in government expenditures accounted for almost 45 percent of the economy's growth in FY 1986.

The January-March quarter's gain was led by personal consumption, which accounts for about 55 percent of GNP. Real growth at a 7.3 percent annual rate was encouraged by the stability of prices. Business investment, led by the electric utilities, remained strong, while government investment rose, spurred by the stimulus package adopted last fall. Surprisingly, the external sector accounted for 0.5 percentage point of the 1.2 percent real quarterly gain, as exports and factor income received from abroad recovered to their highest level since the end of 1985. Japan's investment income from overseas jumped 23.3 percent in the January-March quarter to a record \$9.8 billion, offsetting a decline in export volume.

Despite these generally positive results, some analysts remain pessimistic. The Organization for Economic Cooperation and Development, for example, recently lowered its forecast of real Japanese growth in calendar 1987 to only 2 percent. The EPA criticized this projection because it did not include the expected impact of the Y6 trillion (\$42.9 billion at Y140=\$1.00) stimulus package that is scheduled to be implemented by a special session of the Diet that meets in July. The OECD did concede, though, that the package could raise Japan's growth rate by more than 1 percentage point.

Although the data indicate that Japan's economy is close to a turning point, the growth rate is likely to decelerate in the April-June quarter for several reasons. First, the external sector is likely to slide into the negative column as export volume continues to decline. In addition, the growth in personal consumption will be moderated by the small 0.5 percent rise in summer bonuses, compared to a 4.8 percent increase the preceding year. But Bank of Japan governor Satoshi Sumita expects a gradual but steady expansion in the economy beginning in the latter half of 1987. Mr. Sumita intends to maintain the central bank's expansionary policies that allowed the money supply to increase at a double-digit rate in May for the first time since 1982.

Randall S. Jones

Reports Focus On Trade Surplus, Economic Structure

Two of Japan's most powerful agencies, the Ministry of International Trade and Industry and the Bank of Japan, have called for changes in fiscal and monetary policy in their annual reports. Particular attention is paid to Japan's new position in the global economy and the policies attendant to this status. Both agencies view the current period as a turning point for Japan, raising the stakes in policy debates.

The government has not indicated what if anything it will do about corporate taxes, but the other proposals are practically identical to those submitted at the beginning of this year (see JEI Report No. 20A, May 22, 1987 for details). In addition, the government intends to submit its plan for Y5 trillion (\$35.7 billion) in extra spending for Diet approval to counter lagging domestic growth (see JEI Report No. 21B, June 5, 1987).

The proposals have already attracted opposition party criticism; the popularity of the maruyu system makes it a tempting issue for the opposition to take a hard line on. Its tough stance on the sales tax attracted popular support and a similar position against tampering with the maruyu exemption could win the rival parties more respect. Similarly, the opposition is vigilant for any changes that could lead to tax increases. Even though a consensus on Y1 trillion-plus (\$7.1 billion) in tax reductions has been reached, there is disagreement over its form: the LDP wants to restructure brackets and rates while the opposition advocates a direct refund. In fact, agreement on the length of the extraordinary session is still elusive. The LDP prefers one lasting at least through September so that both the tax and stimulus packages can be approved. Opposition parties are lobbying for a 30-day session, barely enough to pass the tax legislation. The prime minister, after being bloodied in the VAT fight, is working overtime to pave the way for approval of both packages.

Jon Choy

Japan's Stake In South Korea

Escalating protests against the government in South Korea, stemming in part from President Chun Doo Hwan's April 13 decision to end the debate over constitutional reform, has raised concern over that country's political stability. Recent events hold particular interest for Japan, given its proximity to South Korea and the extensive economic links between the two countries.

Korea was Japan's second-largest trading partner in 1986, with two-way trade totaling \$15.8 billion. The Korean market, though, accounted for only 5 percent of Japanese exports compared to the United States' 38.5 percent. In addition, Japanese firms invested \$134 million in Korea in FY 1985, bringing the cumulative total to \$1.7 billion as of March 31, 1986. Among Asian nations, Korea ranked fourth behind Indonesia, Hong Kong and Singapore in Japanese direct foreign investment.

Aided by the steady depreciation of the won relative to the yen during the past two years, Korea has emerged as a major economic competitor to Japan. According to the U.S. Department of Labor, the average hourly manufacturing wage in Korea last year was only \$1.55 compared to \$9.50 in Japan. Korean firms have achieved success in a wide range of fields. With sales of 168,000 cars last year, Hyundai Motor Co. produced the best-selling new import ever in the United States. In video cassette tapes, a market once nearly monopolized by Japan, Korean firms have garnered a 30 percent market share.

But since Korean producers rely heavily on components produced in Japan, Japanese firms have also benefited from their competitors' booming exports, which rose 18 percent to a record \$36 billion in 1986. About 60 percent of the components of Korean-made personal computers, for example, come from Japan.

And Mitsubishi Motors Corp. provides the engine components for Hyundai's cars. Korean manufacturing remains dependent on Japan for a variety of products such as integrated circuits and ball bearings (see Table). Although Korea recorded its first trade surplus in 1986, its deficit with Japan more than doubled to \$5.4 billion. In an effort to reduce the chronic imbalance, Seoul instructed domestic producers last year to substitute U.S. and European supplies for products currently imported from Japan. Despite this attempt to diversify, Japan's share of Korean imports rose to 34.6 percent during the first five months of 1987 compared to 31.4 percent during the year-earlier period.

Randall S. Jones

Korea's Dependence on Japan for Imports of Selected Products, 1986

<u>Product</u>	<u>Dependence on Japan</u>
Glass bulbs	99.2%
Sound recording and reproduction units	96.5
Watch components	87.1
Cathode-ray tubes	84.8
Automotive components	79.9
Metalworking machinery	74.3
Condensers	74.3
Electric motors	72.7
Steel pipes	71.4
Ball bearings	69.9
Tools and special steel	67.7
Transformers, fuses, etc.	65.7
Capacitors	65.3
Textile spinning equipment	63.8
Integrated circuits	53.9
Peripheral computer products	53.1
Switchboards and control panels	38.1
Electronic measuring instruments	34.9

Source: Sanwa Economic Letter, June 1987.

Toshiba Machine Dispute Heats Up Bilateral Defense Issues

Anger is growing in Congress over Toshiba Machine Co., Ltd.'s sale of sophisticated milling machines to the Soviet Union. While the initial protests appeared to be limited, the subject threatens to affect other defense issues and perhaps the overall bilateral relationship.

Partly in response to the Toshiba incident and partly out of historical irritation at Japan's relatively low defense spending, the House of Representatives approved a measure on June 16 urging the State Department to negotiate with Tokyo for compensation for damages incurred as a result of the sale. The Senate got into the act the following day, with Jake Garn (R, Utah), Richard Shelby (D, Ala.) and John Heinz (R, Pa.) proposing a ban on imports of all products manufactured by parent Toshiba Corp. in retaliation for the illegal